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No. 88-1066

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

ESTATE OF GEORGE JOHNSON, ELEANOR MADSEN, CARMEN COLON, CASIMIRA MACIAS, SOLEDAD FREGOSO, MANUEL COLON, HILDA VALDES, CARMEN REGALADO, AMERICA SUAREZ, FERDINAND KANGISER, MARIA ROMERO, RAFAEL MENDOZA, JOSE LUIZ CORONA, HERIBERTO PIZZARO, RAMON GONZALAS, AND GUILLERMINA OLIVARES, for themselves and all participants in the Reliable Profit Sharing Plan Trust except CHARLES W. LEIGH AND ERVIN F. DUSEK, the Plaintiffs,

Petitioners,

v.

CLYDE WILLIAM ENGLE, NATHAN DARDICK, RONALD ZUCKERMAN, LIBCO CORPORATION, TELCO MARKETING SERVICES, INC., TELVEST, INC., THE RELIABLE EMPLOYEES' PROFIT SHARING PLAN TRUST, AND NATIONAL BOULEVARD BANK OF CHICAGO, a National Banking Association,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

BRIEF IN OPPOSITION OF RESPONDENTS NATHAN H DARDICK, RONALD K. ZUCKERMAN AND NATIONAL BOULEVARD BANK

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QUESTION PRESENTED FOR REVIEW*

Whether the Court of Appeals for the Seventh Circuit erred in holding that the District Court was not clearly erroneous in finding that although respondents breached a fiduciary duty owed to a profit sharing plan, they obtained no personal profits through the use of the assets of the profit sharing plan.

* Respondents Nathan H Dardick and Ronald K. Zuckerman are individuals. Respondent National Boulevard Bank is a wholly-owned subsidiary of Boulevard Bancorp, Inc.

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BRIEF IN OPPOSITION OF RESPONDENTS NATHAN H DARDICK, RONALD K. ZUCKERMAN AND NATIONAL BOULEVARD BANK

OPINIONS BELOW

The opinion of the Court of Appeals for the Seventh Circuit for which the petition is sought is reported at *Leigh v. Engle*, 858 F.2d 361 (7th Cir. 1988). The findings of fact and conclusions of law of the District Court for the Northern District of Illinois are reported at 669 F. Supp. 1390 (N.D.Ill. 1987). A Memorandum and Order of the District Court for the Northern District of Illinois is reported at 619 F. Supp. 154 (N.D.Ill. 1985). The first opinion of the Court of Appeals for the Seventh Circuit is reported at 727 F.2d 113 (7th Cir. 1984) ("Leigh I").

STATEMENT OF THE CASE

A. The Parties.

Petitioners are all former employees of Reliable Manufacturing Company ("Reliable") and beneficiaries of the Reliable Employees' Profit Sharing Plan (the "Plan"). Petitioners intervened in a suit originally brought by the former owners of Reliable for the alleged wrongful investment of Plan assets under the Employee Retirement Income Security Act of 1974 ("ERISA").

Respondent Clyde W. Engle is an officer, director and part-owner of respondent Libco Corporation, which purchased Reliable in 1977. Respondents Nathan H Dardick and Ronald K. Zuckerman became administrators of the Plan on September 15, 1977. The National Boulevard Bank became trustee of the Plan in February 1979, after

the present lawsuit was originally filed, and thus was not a party to that lawsuit. After petitioners intervened, they joined in plaintiffs' original wrongful investment claim and added a second claim, for wrongful distribution of Trust assets, in which they named the original defendants and added the Bank as a defendant for that claim alone. The Seventh Circuit found in favor of the Bank on that claim in all respects and petitioners do not seek review of any aspect of the Court's ruling on that claim. Thus, the Bank is not properly a respondent here.

B. The Challenged Investments.

After becoming Plan Administrators and assuming responsibility for Plan assets, Dardick and Zuckerman, upon advice of counsel, decided to diversify the investment of Plan assets and sought advice from a financial analyst. The analyst recommended the common stock of Berkeley Bio-Medical, Inc. ("Berkeley"), Outdoor Sports Industries ("OSI") and Hickory Furniture Company ("Hickory"). Dardick and Zuckerman kept approximately 70 percent of Plan assets in short-term debt instruments and invested the remainder of the assets in the stock of the three companies. The Trust's total investment in Berkeley was $71,580.53; in OSI, $77,736.83; and in Hickory, $72,433.21.

Following independent consultation with the same investment advisor and personal study of the three companies, Engle concluded that each of the three companies were sound and prudent investments, and Engle and related entities began investing in Berkeley, Hickory and OSI. During this time-period, the first half of 1978, Libco had assets of approximately $48 million and a steady cash flow from operating subsidiaries and liquidation of its lease portfolio, Engle had a personal net worth of almost $5

million, and a Libco subsidiary, Telco Marketing Services, had refinanced a bank loan and obtained $1.78 million for use in investments.

1. Berkeley

As to Berkeley, the Trust purchased for $71,580.53, a total of 15,800 shares of stock, constituting .65 percent of the outstanding Berkeley shares. Engle and related entities, not including the Trust, purchased more than 10 percent of the outstanding Berkeley shares. When Engle and related entities filed a Schedule 13D on their Berkeley holdings, they did not identify the Trust as a reporting person, but included the Trust's shares in calculating the shares controlled, thereby forcing an earlier public disclosure of their holdings than would otherwise have been necessary.

Engle became involved in a control contest for Berkeley, which was settled when Engle and related entities agreed to sell their stock at a substantial premium. The Trust was not a part of the original settlement until Dardick insisted that the Trust's shares be bought back at the same price, thereby providing the Trust with a substantial benefit. The Trust enjoyed a profit of $118,500, or 66 percent from the sale of its Berkeley stock.

2. OSI

In the OSI situation, the Trust purchased for $77,736.83 a total of 12,500 shares of stock, constituting .87 percent of the outstanding OSI stock. Engle and related entities, not including the Trust, purchased almost 21 percent of the outstanding OSI stock. The Schedule 13D filed by these entities disclaimed any interest in the Trust assets

but included the Trust shares with those reported and thus again caused an earlier disclosure of the stock holdings of the Engle-related entities than would otherwise have been required.

Although the Engle-related entities were involved in a control contest for OSI, the contest ended when a white knight entered and made a tender offer for all outstanding OSI shares. The Trust tendered its OSI shares and enjoyed a 141 percent profit of $109,763.17.

3. Hickory

As to Hickory, the Trust purchased for $72,433.21 12,000 shares of stock, constituting .67 percent of the shares outstanding. Engle-related entities conducted a control contest for Hickory, and eventually succeeded in gaining majority ownership of the company. Their Schedule 13D again disclaimed any beneficial interest in Trust assets, but again disclosed the Trust's shares. The Trust sold its OSI stock for a 4 percent profit of $2,566.79.

Thus, in little more than one year, the Trust's investments in Berkeley, Hickory and OSI together produced profits for the Trust of $159,249.43, for an overall return on investment of 72 percent. All of these profits were realized by the Trust alone. Respondent Dardick made no personal investment in the stock of Berkeley, OSI or Hickory during the relevant time period and thus enjoyed no profits from those stocks. Respondent Zuckerman's personal investment in the three companies was limited to 1,200 shares of Berkeley stock which he sold for a profit of $3,300.

C. Proceedings Below.

This case was originally tried in 1982 before United States District Court Judge George N. Leighton of the Northern District of Illinois, who entered judgment for defendants in all respects. *Leigh v. Engle*, slip op., No. 78 C 3799 (Nov. 18, 1982). On appeal, the United States Court of Appeals for the Seventh Circuit vacated the judgment and remanded for further proceedings. *Leigh v. Engle*, 727 F.2d 113 (7th Cir. 1984).

The Seventh Circuit reversed Judge Leighton's findings that Dardick and Zuckerman did not breach their fiduciary duties in investing Trust assets in Berkeley, OSI and Hickory, and held that Dardick and Zuckerman breached their fiduciary duties because they invested Trust assets where a potential conflict of interest existed.[1]

The Seventh Circuit ordered the District Court to find "an appropriate measure of damages, if any, with regard to all defendants found to be liable as fiduciaries." 727 F.2d at 137. The Court noted that the case presented "an extraordinarily difficult damages issue" because it required the District Court to determine whether the profits, if any, made by each breaching fiduciary were attributable to its own legitimate efforts or were attributable, in whole or in part, to the use of Trust assets. 727 F.2d at 137-38. The Court analogized the resolution of the causation issue in this ERISA context to resolution of similar

[1] The Seventh Circuit also held that respondents Engle and Libco were fiduciaries with respect to the selection, retention and supervision of Plan administrators and remanded for determination of whether they breached those fiduciary duties. The Seventh Circuit also vacated Judge Leighton's findings regarding the alleged delay in distribution of Trust assets, an issue not before the Court on this petition.

damages causation questions, such as where a copyright infringer has realized profits from both his own efforts and from his infringement, or where Trust assets have been commingled. The Court placed the burden on the breaching fiduciaries to show which profits were attributable to their own investments, apart from use or control of Trust assets, and required that all reasonable doubts be resolved in favor of the Trust beneficiaries. Petitioners never sought certiorari from this Court for the Seventh Circuit's damage theory formulation in *Leigh I*.

After retrial in 1986, District Court Judge Brian Barnett Duff entered his findings of fact and conclusions of law on August 27, 1987. 669 F. Supp. 1390 (N.D.Ill. 1987). In determining the appropriate measure of damages arising from the wrongful investment of Trust assets, Judge Duff found that the Trust suffered an opportunity loss of $6,704 from its investment in Hickory. The court found that respondents did not realize any profits from the investment of Trust assets in Berkeley, Hickory and OSI. The court found defendants did not need the Trust assets to enhance their own investments, and that the Trust investments did not affect the price of Berkeley, OSI or Hickory stock, did not allow defendants to prolong the secrecy of their acquisition programs, and did not affect the decisions of the other companies involved in the control contests to purchase stock held by Engle-related companies.

On appeal, the Seventh Circuit affirmed the District Court's findings and conclusions in all respects. Again terming the damage calculation a "formidable task", the Seventh Circuit noted that "the District Court did an admirable job with it." The Seventh Circuit again rejected petitioners' claim that they were entitled to all profits of Engle and related entities on their investments in Berkeley, OSI, and Hickory, and affirmed the trial court's finding

that respondents proved that any profits they realized on these investments were obtained through their own efforts and not through use of Trust assets. The Seventh Circuit also found not clearly erroneous the District Court's finding that petitioners suffered $6,704 in damages from the Trust investment in Hickory since the Hickory investment did not produce as high a return as more appropriate investment vehicles.

Petitioners filed the present petition for a writ of certiorari on December 20, 1988.

REASONS FOR DENYING THE WRIT

The Petition for a Writ of Certiorari should be denied because the decision of the Court of Appeals for the Seventh Circuit applied the correct legal standard and was correctly decided. The decision does not conflict with any prior decision of this Court or any federal appellate court. The Seventh Circuit decision did not involve an important question of federal law, but rather involved simply a holding that the trial court was not clearly erroneous in its factual findings that respondents obtained no personal profits through the use of Trust assets.

I.

THE COURT USED THE APPROPRIATE DISGORGEMENT ANALYSIS IN FINDING NO PROFITS WERE OBTAINED THROUGH USE OF TRUST ASSETS.

Section 1109(a) of ERISA provides that a breaching fiduciary must "restore to such Plan any profits of such fiduciary which have been made through use of assets of

the Plan by the fiduciary." 29 U.S.C. § 1109(a). In *Leigh I*, the Seventh Circuit held that the burden was on defendants found to have breached their fiduciary duties to show which profits, if any, were attributable to their own investments apart from control of the Trust assets. 727 F.2d at 138. The Seventh Circuit "read section 1109(a), providing that the fiduciary 'shall be subject to such other equitable or remedial relief as the court may deem appropriate,' as authorizing us to cast the burden of proof on the defendants here to insure that the disgorgement remedy is effective." 727 F.2d at 139. On that basis, the Seventh Circuit remanded to the District Court for determination of which of defendants' profits, if any, were made through use of Trust assets. Petitioners never sought relief in this Court from the Seventh Circuit's damages guidelines.

On remand, the District Court followed those guidelines and found that respondents made no profits through the use of Trust assets. 669 F. Supp. at 1401, 1403, 1404. On appeal, the Seventh Circuit found that the District Court did an "admirable job" with the "formidable task" of damages calculation, and affirmed. 858 F.2d at 366. The Seventh Circuit noted that "[i]n order to avoid disgorgement of part of its profits, the Engle group had to show that they did not result from misuse of trust assets. Judge Duff correctly held that defendants met this burden." 858 F.2d at 366.

The Seventh Circuit advanced five theories that potentially might have provided a causal connection between the use of Plan assets and the profits made by the Engle entities on the investment of their own assets. First, the Engle entities could have hidden stock from disclosure requirements by buying it with Trust assets. Second, the Trust assets could have provided the Engle entities with

otherwise unavailable capital. Third, the Trust's stock holdings could have enhanced the influence of Engle in control contests. Fourth, the Trust's holdings could have undermined settlement of the control contests. Finally, the Trust's purchases could have affected the market price of stock. However, after analyzing each of the five theories, the District Court found, and the Seventh Circuit affirmed, that on each, respondents had satisfied their burden of proving no causal connection. *See* 858 F.2d at 366-67.

Notwithstanding the thorough fact-finding and careful analysis on the causation issue, petitioners object because the result is to deny petitioners recovery of all of the profits realized by Engle and related entities through their separate investments in Berkeley, OSI and Hickory. Throughout this litigation, petitioners have repeatedly sought to obtain all profits earned by Engle and related entities but have been repeatedly rebuffed and criticized for their overreaching. *See, e.g.*, 858 F.2d at 366; 727 F.2d at 137. Petitioners persist, however, because of a misguided notion that once a prohibited transaction has been found, all profits of the fiduciary must be paid to the beneficiaries, regardless whether there is any causal connection between the breach and the profits, if any.

Petitioners' argument effectively eliminates the causation requirement from the remedial provisions of section 1109(a). *Cf. Brandt v. Grounds*, 687 F.2d 895, 898 (7th Cir. 1982) ("causal connection is required between the breach of fiduciary duty and the losses incurred by the plan"); *Chambers v. Kaleidoscope, Inc. Profit Sharing Plan and Trust*, 650 F. Supp. 359, 378 (N.D. Ga. 1986) (awards damages causally related to breach). Because they thoroughly misread the statutory language and misrepresent the Seventh Circuit's opinion, petitioners argue that

that decision allows a breaching fiduciary to keep illegal profits and that a plan has no remedy against a breaching fiduciary and his illegal profits unless the plan has suffered a loss from the breach. Petitioners' arguments are plainly incorrect, and are thoroughly discredited by the Seventh Circuit's straightforward application of the remedial scheme of section 1109(a). The Seventh Circuit decision is correct and need not be disturbed.

II.

THE SEVENTH CIRCUIT'S DECISION DOES NOT CONFLICT WITH ANY DECISIONS OF THIS COURT.

Petitioners claim that the Seventh Circuit decision is "probably in conflict with existing applicable decisions of this Court," but manage to set up conflicts with other cases only by misrepresenting the Seventh Circuit's decision. The Seventh Circuit's decision was legally correct and consistent with principles of ERISA and trust law upon which ERISA is based. Although it broke no new legal ground, the decision is wholly consistent with prior decisions of this Court and other federal courts in this area.

Under traditional trust law, a trustee is "liable for any profit he has made through the breach of trust, even though the trust suffered no loss." Bogert on Trusts, § 701, p. 206 (rev. 2d ed. 1982). The same principle is contained in ERISA section 1109(a) and was recognized throughout the Seventh Circuit opinion. No disgorgement was required by the Seventh Circuit, however, because the Court found that no one made any profit "through the breach of trust." Petitioners may deny the result of the fact finding, but application of the legal principle is unassailable.

Because petitioners misconstrue the facts here, they fail to recognize the distinctions between the present case and those cases with which they claim it conflicts. In both *Mosser v. Darrow*, 341 U.S. 267 (1951) and *Magruder v. Drury*, 235 U.S. 106 (1914), the trustee was surcharged because he allowed a third party to take for itself part of the profit rightfully belonging to the trust. In the present case, the lower courts stood ready to do likewise but after careful scrutiny determined that no one obtained a personal profit through use of trust assets. Similarly, with numerous other of petitioners' statements of general principles of trust law, the principles remain applicable, but stand in harmony with the Seventh Circuit opinion.

Petitioners disingenuously cite *Massachusetts Mutual Life Insurance Co. v. Russell*, 473 U.S. 134 (1985) and argue that the present case somehow presents a question left open by that decision. In *Massachusetts Mutual*, this Court held that section 1109(a) did not provide a cause of action for extracontractual or punitive damages to a beneficiary caused by improper processing of benefit claims. Petitioners claim that *Massachusetts Mutual* left open the question whether disgorgement of profits is available as "other equitable or remedial relief" under section 1109(a). In fact, disgorgement of "profits of such fiduciary made through use of assets of the plan by the fiduciary" is expressly provided for in section 1109(a), and was the remedy the Seventh Circuit analyzed and stood ready to apply in its opinion. The Court declined to order the disgorgement remedy here not because of any legal uncertainty or error, but because every federal judge that analyzed the facts determined that there was no causation between the breach by respondents and profits enjoyed by respondents as a result of their own investments and efforts.

The decision below is correct and consistent with prior law.

III.

PETITIONERS ARE EFFECTIVELY SEEKING REVIEW OF THE SEVENTH CIRCUIT OPINION IN *LEIGH I* AND ARE BARRED FROM DOING SO.

Petitioner claims that the Seventh Circuit's analysis was legally incorrect because it relied on a causation standard announced in *Leigh I* analogizing ERISA damages to apportionment of a copyright infringer's profits. In challenging this damages formulation, petitioners effectively ask this Court to rule as legally incorrect not the Seventh Circuit's decision in *Leigh II*, but rather the decision in *Leigh I*, 727 F.2d 113 (7th Cir. 1984). In *Leigh I*, the Seventh Circuit analogized to the copyright area in setting forth the causation guidelines for determining whether the profits of a breaching fiduciary are attributable, in whole or in part, to the use of the Trust assets. In *Leigh II*, the Seventh Circuit merely reviewed the District Court's fact findings on remand to determine if the court properly analyzed those causation guidelines. Petitioners here reject the notion that causation is even an issue once a prohibited transaction is found, and thus ignore the individual findings of *Leigh II*. Petitioners' challenge here is to the underlying causation guidelines enunciated by the court in *Leigh I*. Because the time to challenge *Leigh I* has long since expired, petitioners' request for review of that opinion should be here denied.

CONCLUSION

The Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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Dated: January 20, 1989

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